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April 7, 2008

Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
Washington, DC 20551

Re: Docket No. R-1305
Proposed Rules Changes to Reg. Z

Dear Ms. Johnson:

Iowa Bankers Association ("IBA") is a trade association representing nearly 95% of banks and savings and loan associations in the State of Iowa. We appreciate this opportunity to comment on the proposed amendments to Regulation Z meant to better protect consumers in the mortgage market from unfair, abusive or deceptive lending practices, provide consumers transaction-specific disclosures earlier in the mortgage shopping process and to ensure mortgage advertisements for mortgage loans provide accurate and balanced information and do not contain misleading representations.

The majority of our member banks are small or intermediate small banks for Community Reinvestment Act (CRA) purposes that originate, portfolio and service the majority of their mortgage loans. Most of these banks offer three, five, or seven-year adjustable rate mortgage (ARM) or balloon mortgage loans. Due to competitive forces, however, many of our members now also offer longer term, fixed rate loans they originate and sell to secondary market investors after loan closing. Only a small percentage of these secondary market loans qualify as "sub-prime loans" and few, if any, of our members have entered into the nontraditional mortgage loan product market with "interest only" or "payment option" ARMs.

In developing our comments contained herein, the IBA invited its membership to respond to questions posed in the proposed rulemaking. Our membership is comprised of bankers from around the state, representing institutions of various charters, asset sizes, product mixes and community demographics.

I. Proposed Revisions to §226.34 Prohibited Practices Related to Credit Transactions Subject to §226.32

The proposed revisions prohibits lenders from engaging in a pattern or practice of extending credit subject to §226.32 based on the value of the collateral property without regard to the consumer's repayment ability as of the consummation date. This common-sense approach is currently employed by the majority of our members and as such, we have no major objections to the revisions to this section.

II. New Protections Covering Higher Priced Mortgage Loans (§226.35)

§226.35(a) - Definition of "Higher-Priced Mortgage Loan"

The proposal creates a new "higher-priced mortgage loan" product which is defined as a consumer credit transaction that is secured by the consumer's principal dwelling in which the annual percentage rate (APR) at consummation will exceed the yield on comparable Treasury securities by three or more percentage points for loans secured by a first lien on a dwelling, or by five or more percentage points for loans secured by a subordinate lien on a dwelling. As participants in the mortgage industry, we have several concerns regarding the standards by which a "higher price mortgage loan" is determined.

- The three and five percent thresholds are too restrictive and will go beyond the goal of capturing sub-prime loans and impact loans in the prime market. Recent market activity makes one wonder if the Treasury rates are even the proper index. The Treasury markets in the first quarter of 2008 have been so volatile with wide swings that the preceding month's Treasury yields have not even been comparable to current mortgage rates 30 days later. In addition, while historical spreads between prime mortgage rates and Treasury levels have been fairly consistent and predictable, recent spreads have increased at least 100 basis points over traditional levels. This further brings into question the reliability of Treasuries as an accurate barometer for appropriate mortgage note rates, especially in this current environment of uncertainty. Frequent changes in the fed funds rate, which we are currently experiencing, also impact the fluctuating relationship between Treasury yields and mortgage rates.

- The rules for selection of comparable Treasury securities for determining if a loan is deemed to be a "higher-priced mortgage loan" are far too complicated and inconsistent with §226.32's methodology of selecting the appropriate Treasury rate for purposes of determining rate spread. A lender is directed to use the yield on the Treasury security as of the 15th day of the month of the preceding month if the creditor receives the application between the 1st and the 14th day of the month and as of the 15th day of the current month if the creditor receives the application on or after the 15th day for purposes of determining a "higher-priced loan" per §226.35. This formula for matching the loan rate to comparable Treasury yields is consistent with the process used under the Home Mortgage Disclosure Act (HMDA), Reg. C to determine the APR rate spread. By contrast, for Reg. Z §226.32 purposes, a high-cost (HOEPA) loan is determined by comparing the Treasury rate as of as of the fifteenth day of the month immediately proceeding the month in which the application for the extension of credit is received by the creditor. We fail to see the perceived benefit of the different Treasury selection process over the burden placed upon lenders to make the appropriate selection. For simplicity purposes and in hope of fostering greater compliance, it would seem in the best interest of all to make the Treasury selection process consistent in determining the rate spread under Reg. Z §§226.32 and 226.35 as well as Reg. C §203.4(a)(12).

- The criteria outlined for selecting the proper Treasury based on the term of the initial rate for variable rate loan products and the loan term for fixed rate loan products appears to presume all lenders utilize the same indices for mortgage loan products as well as employ the same pricing strategies. While Treasury yields are most commonly used as indices for secondary market investors, lenders retaining loans within their own portfolios often use internal indices or indices that are less subject to market fluctuations such as Fed funds, LIBOR, Prime, etc. As previously mentioned, the proposed process is not consistent the selection process in §226.32 where the creditor selects a comparable Treasury yield. For community banks lacking adequate resources and software programs to assist in determining these differing comparable yields, this will surely result in rate spread calculation errors and subsequently, regulatory criticism.

§226.35(b) Rules for Higher Priced Loan

The proposal outlines a number of requirements and prohibitions for lenders making a loan that meets the definition of a "higher-priced mortgage loan." Iowa state law prohibits prepayment penalties, so we have no objections to the prepayment penalty prohibition, but we do have concerns regarding two provisions of this section.

- The proposal prohibits a creditor from using amounts of income or assets in approving an extension of credit unless the creditor first verifies such amounts by the consumer's IRS form W-2, tax return, payroll receipt, financial institution record or other third party document that provide reasonably reliable evidence of the consumer's income or assets. The creditor is also required to document its verification of income and assets. Certainly prudent underwriting standards include verification of income and we have no objections to the basic provision. We do have concerns however, regarding examiner interpretation of properly documenting income and assets. Creditors need to be provided flexibility in verifying income – especially for established borrowers with whom the creditor has previous lending history and has gone through the verification process with previous loan requests.

  Also, latitude must be given to lenders for verifying income of self-employed borrowers as well as commissioned employees with business expenses that are not reimbursed by their employer. Accounting firms are quite proficient at using the tax code to their client's advantage to reduce their taxable income. If lenders are not granted some latitude in calculating and verifying income for the self-employed or are unable to take into consideration other extenuating circumstances (such as credit history, over all net worth, loan-to-value, etc.), the self-employed will virtually find their financing options have disappeared. We are not suggesting that these borrowers should not be subject to strict underwriting standards, rather the totality of the borrower's strengths and weaknesses should be taken into consideration.

- Under the proposal, lenders making "higher-priced mortgage loans" are required to establish an escrow account for first lien loans to accommodate the payment of property taxes, hazard insurance premiums, premiums for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss and premiums for other mortgage-related insurance. A presumption appears to be made that most lenders offer escrow account services and the proposed escrow requirement will not impose an additional burden on creditors, when in fact, this is the provision for which we have received the largest objections from our members. The requirement to establish an escrow account for "all first lien higher-priced mortgage loans" imposes a tremendous burden on small lenders, particularly in light of the very narrow rate spreads included in the proposal and the resulting number of loans that may require escrow accounts. Many of our lenders do not currently offer escrow account services because they lack the resources (software systems and personnel) to operate the service in compliance with the Real Estate Settlement Procedures Act (RESPA) escrow provisions. Also keep in mind, most of these same lenders are not intentionally making "sub-prime loans," rather, they are more likely to trigger the rate threshold of "higher-priced mortgage loans" by making an accommodation loan to an established customer. Many of our members have indicated they will simply no longer make accommodation loans that meet the definition of a "higher-priced mortgage loan" if they are forced to establish escrow accounts, which will leave established customers with no other choice than to look for financing elsewhere, with lenders they do not know, with whom they have no established relationship and that often are not driven by the consumer's best interest.

  The prudent use of more conservative underwriting standards, many of which are included in this proposal (such as verifying income, calculating debt-to-income ratios using the highest rate possible on a variable rate loan and including taxes and insurance when calculating debt-to-income ratios), eliminates the need for this escrow provision. At the very least, we ask that this requirement only be imposed on creditors that routinely offer escrow services subject to RESPA to their mortgage customers.

III. New Protections for All Loans Secured by Consumer's Dwelling (§226.36)

The proposal outlines a number of prohibited practices in connection with credit secured by a consumer's principal dwelling. Again, Iowa state law is very consumer-protective and currently prohibits appraisal coercion as well as abusive servicing practices such as pyramiding late fees, failing to credit a payment to the consumer's loan account as of the date of receipt, and delaying the release of mortgages upon payoff. We have no objections to most of these protections, but we do have concerns regarding one provision of this section.

- §226.36(a) - Creditors are prohibited from making a payment directly or indirectly, to a mortgage broker unless the broker enters into a written agreement with specific disclosures to the consumer. We have no objection to the principal concept of the mortgage broker disclosure or the content of the disclosure itself. However, we do have concerns about the timing of the written agreement. As proposed, the agreement must be entered into **before** the consumer pays a fee to any person in connection with the mortgage transaction *or submits a written application to the broker for the transaction*, whichever is earlier. Loan pricing has become a very complicated process based on the borrower's credit score, the type of collateral, total loan-to-value, the loan purpose (cash out vs. no cash out), etc. It would be virtually impossible for a mortgage broker to accurately disclose the total amount of compensation he/she will receive without a completed application and credit report from the applicant. We certainly have no objection to prohibiting the broker from collecting a fee from the borrower until this agreement has been entered into, but it is impractical to ask a broker to accurately disclose the broker's fee before receiving a completed application and knowing how the applicant's loan will be priced.

IV. Advertising Rules Revisions

While we appreciate the Board's desire to ensure consumers are provided fair and accurate information in marketing and advertising mortgage loans, we believe the mandates for additional disclosures when advertising loans secured by a dwelling will create a competitive disadvantage for community banks. With the costs of print media priced by the columnar inch, the required additional disclosures and resulting additional costs to publish may dissuade community bankers from advertising mortgage loan products. Under the current regulatory requirements, we find may community banks that hesitate to include even minimal pricing information in mortgage loan ads due to the additional disclosures that are triggered. The additional disclosures proposed would surely dissuade even more bankers from producing print advertisements due to the complexity of the requirements and the potential penalties for noncompliance.

Further, we object to the Board's definition of "equally prominent" for certain required disclosures in advertisements for loans having a reduced introductory rate (disclosures such as the term "introductory rate," the period of time that introductory rates or payments will apply, and the index and margin for variable rate transactions). In the proposal, the Board deems "equally prominent" to mean such disclosures must be made in the same type size as the introductory rate or payment being advertised. In the Board' outreach, the research indicated that appropriate disclosures were made in a footnote, but there is no indication that consumers didn't read or recognize such disclosures or that lenders failed to make all required disclosures under Reg. Z §§ 226.16 or 226.24. We support the proposed recommendation that disclosures be positioned within the advertisement so that they are adjacent to, above or below the related rate or payment being advertised; however, we recommend that the standard for "equally prominent" not require the related disclosure be made in the same size font.

In response to specific questions posed for comment in the proposal:

- §§ 226.16(d)(4) and 226.24(h) The requirement to disclose in advertisements that the interest on the portion of credit extended that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes should be limited to advertisements that **state** the creditor provides extensions of credit that exceed the dwelling's fair market value. We oppose any requirement that this new disclosure be displayed in advertisements that "imply" extensions of credit may exceed the fair market value of the dwelling, as this is a subjective term that would create significant inconsistencies in the enforcement of this new rule.

- §226.26(d) Proposed Comment 16-6 and § 226.24(b) Proposed Comment 24(b)-5 We object to the proposed requirement that for radio and television advertisements, disclosures must be made at "a speed and volume sufficient for a consumer to hear and comprehend." This is an indeterminate requirement and is likely to dissuade many banks from using these media for advertising purposes. Rather than impose such dubious requirements for advertising via these media, we recommend the Board consider applying reduced requirements for radio and television advertisements, similar to the reduced disclosure requirements for these media under the Board's Regulation DD for deposit accounts. For dwelling secured loans, we recommend that such reduced requirements should include the introductory APR and time period for the introductory APR (if applicable), a current APR (or subsequent APR following an introductory period, if applicable) for the product being advertised, a statement that the APR and payments will vary (for variable rate mortgage products), and a statement to contact a lender at a toll-free number for important additional information. Advertisements in these media are not intended to provide all relative information about a product, rather to garner interest in such product. Consumers must take some initiative in contacting lenders for additional information, at which point full disclosure can be provided.

- § 226.24(f)(2) We object to the requirement that rates disclosed in advertisements comply with the accuracy standards in §§ 226.17(c) and 226.22. Applying to advertisements the APR and finance charge tolerances, which under the Act and regulation are intended for early and final disclosures, seems a ridiculous exercise in regulatory oversight and burden. We have no objection to a requirement that the advertised APR is current and must be supported by typical mortgage transactions of the lender, but to apply a tolerance to such advertisement does little to advance a consumer's knowledge or understanding of the advertised product.

V. Improved Disclosures for All Closed-End Loans

The revisions to §226.19(a)(1) would require early Truth in Lending disclosures (TILs) on all closed-end loans secured by borrower's principal residence including home equity loans and refinances. Many of our members indicated they routinely provide an early TIL on the refinance of first mortgage loans and that many secondary market investors require this disclosure even though it is not currently required by Reg. Z. However, we see little added benefit to providing an early TIL for home equity and subordinate lien loans. These loans are typically fixed rate loans, often subject to state consumer credit code statutes that contain additional protective measures, and are more simplified loan products in nature. In addition, itemized RESPA disclosures (the Good Faith Estimate (GFE)) are required, providing consumers with information related to closing costs associated with home equity loans.

Unintended Consequences
Recent history has shown the addition of complex regulations and consumer disclosures has done little to mitigate the risk in the mortgage market, nor has it protected consumers from unscrupulous mortgage brokers and lenders. The crisis in the sub-prime mortgage market occurred primarily due to unequal regulatory oversight and enforcement. Our fear is legitimate lenders, particularly regulated financial institutions – small community banks, will quit making "higher priced mortgage loans" if they are subjected to additional disclosure and servicing requirements or find themselves subject to regulatory enforcement action because they inadvertently made a non-compliant "higher-priced mortgage loan." The end result is those consumers desperate for mortgage financing, whether for purchase, refinance or equity-secured loans for other consumer purpose, will have no other option than unregulated finance companies or lenders, which only escalates the problems that led to the current mortgage crisis. The answer is not more regulation, but appropriate enforcement and oversight of **all** the players in the market – not just the federally regulated financial institutions!

Clearly, this is not the time for additional regulatory burden. The costs associated with implementing the proposed amendments to Reg. Z will be enormous – reprogramming and software update costs, development and production of new disclosures, training of personnel, and implementation of additional internal review and control procedures. Banks regularly seek ways to assist their customers in today's economic environment by modifying contract terms, reducing interest rates, converting variable loans to fixed, and writing down balances to avoid foreclosure. These practices greatly assist consumers, but typically result in lost revenues for the institutions. In addition, lenders are battling losses, potential losses and increased due diligence costs related to increasing mortgage loan fraud. Couple these losses with the expense of implementing extensive regulatory changes, and the costs may be the demise of the community bank. We hear regularly from our community bankers that "banking isn't fun anymore"; that because of the heavy regulatory burden, bankers aren't able to focus their attention on serving and marketing to their customers, developing innovative community lending programs, or maintaining a competitive position against much larger financial institutions. Perhaps the Board and other federal regulatory agencies should refrain from proposing and/or implementing any new regulatory requirements until our economy stabilizes, the housing market adjusts appropriately, and Congress settles on its housing bill.

Thank you for the opportunity to comment on this important proposed regulation. We appreciate your consideration of our comments and suggestions. If you have questions related to this letter, you may contact us at the Iowa Bankers Association, 515-286-4300 or via e-mail,.

Sincerely,

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